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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-454

MOORMAN MANUFACTURING COMPANY,
Appellant

v.

G. D. BAIR, DIRECTOR OF REVENUE, STATE OF IOWA,
Appellee

On Appeal from the Supreme Court of the State of Iowa

MOTION OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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The Committee on State Taxation of the Council of State Chambers of Commerce ("COST") hereby respectfully moves for leave to file the attached Brief *Amicus Curiae* in Support of Appellant's Jurisdictional Statement. The consent of the attorney for the Appellant has been obtained. The consent of the attorney for the Appellee was requested but refused. The Appellant's letter of consent and the Appellee's letter of refusal are submitted herewith.

COST consists of over 100 companies which have multi-state operations and derive income from multi-state sources. The members of COST have a vital interest in the uniform apportionment of income among the states and in the prevention of multiple state taxation. COST has long been involved in the study of interstate business transactions and both COST and its members have accumulated a great deal of expertise with respect to interstate taxation. Accordingly, COST believes it can make a significant contribution to the Court's consideration of Appellant's Jurisdictional Statement.

Respectfully submitted,

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Attorneys for Amicus Curiae

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BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

QUESTION PRESENTED

Whether net income tax on corporations imposed by the Code of Iowa, which attributes to Iowa 100% of the income from the sale of goods manufactured without Iowa, but sold within Iowa, so discriminates against interstate commerce as to violate the Commerce Clause and so unfairly apportions the income derived from such activity as to offend due process.

INTEREST OF THE AMICUS

The interest of the *Amicus* Committee on State Taxation of the Council of State Chambers of Commerce (COST), which consists of over 100 companies deriving income from multi-state sources, is set out in the accompanying motion of COST for leave to file this brief as *amicus curiae*.

ARGUMENT

The Court should hear this case because it presents an important constitutional issue concerning state taxation of interstate commerce—whether a single sales-factor apportionment formula violates the Commerce Clause of the Constitution and the due process clause of the Fourteenth Amendment—which this Court discussed, but did not decide, in *General Motors Corporation* v. *District of Columbia*, 380 U.S. 553. Iowa's single "sales-factor formula" violates the Commerce Clause for two reasons: it leads ineluctably to multiple taxation of foreign corporations doing business in Iowa, and it inevitably discriminates against interstate commerce by affording local manufacturers a competitive advantage over their foreign rivals. In addition, Iowa's tax offends due process by arrogating corporate income to the state out of all proportion to the business activities within the state. The Court also should hear the appeal of Moorman Manufacturing Company because its affirmance of the judgment below would undermine the gains toward uniformity of apportionment formulae which *General Motors* has promoted and would encourage an emerging trend toward parochial and protectionist state taxation of interstate commerce.

1. Iowa imposes an income tax on corporations whose business is carried on partly within and partly without the state. Where a corporation's income is derived from the manufacture or sale of goods both within and without the state, Iowa employs a single "sales-factor formula" under which the corporation's apportionable net income [1] is attributed to Iowa "in that proportion which the gross sales made within the state bear to the total gross sales." Section 422.33(1)(b), Code of Iowa.[2]

In *General Motors* the Court considered a single "sales-factor formula" and found it unauthorized by statute. While not deciding the constitutional question, the Court's statutory analysis found "support in the consequences which a contrary view would have for the over-all pattern of taxation of income derived from interstate commerce." 380 U.S. at 559. The Court added that the fact that "the sheer inconsistency of the District [sales-factor] formula with that generally prevailing may tend to result in the unhealthy fragmentation of enterprise and an uneconomic pattern of plant location" was "an added reason" supporting its statutory construction. 380 U.S. at 560. With Iowa's similar statute now conclusively construed by the state Supreme Court, those "consequences" have been actualized, and the constitutional questions must be faced.

Iowa is the only state requiring the division of income on the basis of the single "sales-factor formula" (J.S. App. A, p. A5; J.S. App. B, p. A37). Forty-four [3] of

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[1] Certain income of the corporation, such as interest, dividends, rents and royalties, is wholly attributed to the state of its geographic source. Section 422.33(1)(a), Code of Iowa. The remainder of the corporation's net income is apportioned.

[2] Sales are attributed to the state of destination, not of origin. Section 422.33(1)(b), Code of Iowa.

[3] Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia and Wisconsin.

the forty-five other states (including the District of Columbia) which impose a corporate income tax utilize a three-factor apportionment formula which takes into account the geographical distribution of a corporation's payroll, property and sales.[4] Thus, this case does not present the Court with the task of choosing between the Iowa and Illinois apportionment formulae. Rather, the question before the Court is whether the Iowa apportionment formula, which is "seriously at variance with those prevailing in the vast majority of States and creates substantial dangers of multiple taxation" (*General Motors, supra*, 380 U.S. at 556-557), violates the Commerce Clause and denies due process.

2. Iowa's deviate single sales-factor formula violates the Commerce Clause because it leads ineluctably to multiple taxation of foreign corporations doing business in Iowa. As this Court noted in *General Motors, supra*, 380 U.S. at 559-560:

> The use of an apportionment formula based wholly on the sales factor, in the context of general use of the three-factor approach, will ordinarily result in multiple taxation of corporate net income; for the States in which the property and payroll of the corporation are located will allocate to themselves 67% of the corporation's income, whereas the jurisdictions in which the sales are made will allocate 100% of the income to themselves.

Iowa has recognized that its taxing system has precisely this result. Appellee Bair acknowledged in his opinion affirming the assessment against Moorman Manufacturing Co. (Moorman) that "because of the differences in the

[4] Colorado also has a two-factor property and sales formula, and Missouri a one-factor sales formula, which are available to taxpayers at their option as alternatives to the three-factor formula. The forty-fifth state, West Virginia, uses a two-factor formula which omits the sales component of the traditional three-factor formula.

types of apportionment formulae and tax bases among the states, double taxation can and does result" [5] (J.S. App. A, p. A6).

While a state may impose a net income tax on the portion of a foreign corporation's net income earned from, and fairly apportioned to, the taxing state (*Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450), it is equally settled that a state may not "impose a tax which discriminates against interstate commerce * * * by subjecting interstate commerce to the burden of 'multiple taxation' * * *." *Id.* at 458; *see also Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157; *J.D. Adams Manufacturing Co.* v. *Storen*, 304 U.S. 307.

3. The same interaction of Iowa's unique single sales-factor formula with the other states' evenhanded three-

[5] The district court found on stipulated facts that (in 1968) Illinois, applying the three-factor formula, apportioned to itself 41.76% of the income from sales to Iowa customers of goods manufactured in Illinois, because of associated plant and payroll in Illinois. Iowa, using its single sales-factor formula, attributed to itself 100% of the income from the same sales. Thus, "the total percentage of income [from Iowa sales] which must bear a corporate tax between these two states [is] 141.76% (J.S. App. B, p. A36).

The Supreme Court of Iowa's rejection of this finding is unpersuasive. That court denied that double taxation had been shown because it found that "a corporation in Moorman's situation is not taxed by Iowa on 100% of its income from Iowa sales" (J.S. App. C, p. A82). The Court reached this conclusion because of certain "potentially large" deductions from federal "taxable income" allowed in calculating Iowa net income, such as a deduction for 50% of the corporation's federal tax liability. This ignores the fact that certain additions, as well as deductions, are made to federal taxable income in arriving at Iowa net income. Section 422.35, Code of Iowa. In any event, the definition of "net income" is irrelevant to the issue of apportionment. Here, as the district court found, Iowa apportioned to itself 100% of Moorman's net income from sales to Iowa customers. This Court recognized in *General Motors* that a single sales-factor apportionment formula results in the attribution of 100% of the income in question to the jurisdiction having such a formula. *General Motors, supra*, 380 U.S. at 557, 560.

factor approach inevitably discriminates against interstate commerce by affording local manufacturers a competitive advantage over their foreign rivals. The Court noted this consequence in *General Motors*, *supra*, 380 U.S. at 560.

> [I]n some cases enterprises will have their payroll and plant located in the sales-factor jurisdictions and make their sales in the three-factor jurisdictions so that only 33% of their incomes will be subject to state taxation.

The district court observed this precise effect in this case of Iowa's single sales-factor formula (J.S. App. A, p. A38).

> While Moorman's business in Iowa is subjected to the double tax of both Iowa and Illinois, a similarly situated Iowa interstate manufacturer shipping goods, for example, to Illinois would pay taxes only in Illinois; then on the one-third portion of its business activity there represented by its Illinois sales.

Iowa's single sales-factor formula affords this commercial advantage to Iowa-based manufacturers, not only in relation to Illinois-based competitors, but over all interstate businesses making sales in Iowa whose plants and payroll are located in any of the forty-five other states that impose a corporate income tax, because all of the other forty-five states utilize property and payroll in their apportionment formulae.[6] *See supra* pp. 3-4.

The granting of such advantages to local enterprises, which are withheld from foreign corporations, violates

[6] This advantage would exist to a lesser extent over such interstate businesses operating in both Iowa and Colorado which elect to use Colorado's alternative two-factor property and sales apportionment formula. The advantage would not exist over interstate businesses operating in both Iowa and Missouri which elect to use Missouri's alternative single sales-factor apportionment formula. *See supra* p. 4 n. 4.

the Commerce Clause. In *Northwestern States Portland Cement Co.* v. *Minnesota*, *supra*, 358 U.S. at 458, this Court observed that a state may not "impose a tax which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business, *Memphis Steam Laundry* v. *Stone*, 342 U.S. 389 (1952); *Nippert* v. *Richmond*, 327 U.S. 416 (1946) * * *."

4. In addition, Iowa's tax offends due process by arrogating corporate income to the state out of all proportion to the business activities within the state. This Court has held that a state may impose a tax on a foreign corporation doing business within the state, "if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444. That requirement is satisfied "if the tax is fairly apportioned to the commerce carried on within the State." *Ott* v. *Mississippi Valley Barge Line Co.*, 336 U.S. 169, 174; *Northwestern States Portland Cement Co.* v. *Minnesota*, *supra*, 358 U.S. at 452.

For this reason, the Court held in *Norfolk & Western Railway Co.* v. *Missouri State Tax Commission*, 390 U.S. 317, 325, n.5:

> A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to "project the taxing power of the state plainly beyond its borders." *Nashville, C. & St. L.R. Co.* v. *Browning*, 310 U.S. 362, 365 (1940). Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing state. *Fargo* v. *Hart*, 193 U.S. 490, 499-500 (1904) [footnote omitted].

And in *General Motors, supra,* 380 U.S. at 561, in criticizing the single sales-factor formula, the Court recalled that "it has sought to ensure that the [income apportionment] methods used display a modicum of reasonable relation to corporate activities within the State." Noting that an income apportionment formula should approximate "the distribution of either a corporation's sources of income or the social costs which it generates," the Court concluded that "the geographic distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus of either factor." *Id.*

Iowa's single sales factor fails to satisfy these requirements of due process on the facts of this case. On the basis of stipulated facts the district court found (J.S. App. B, pp. A28-A29):

> Since the largest quantum of capital and labor respecting its [Moorman's] product sold here results from its Illinois relationship, the Iowa apportionment formula fails to reasonably apportion profits traceable to Illinois operations and taxes those activities occurring in Illinois.

In reversing, the Supreme Court of Iowa did not dispute the factual conclusion of the district court, but nevertheless found that the Iowa formula (J.S. App. C, pp. A78-A79)

> is fairly calculated to assign to Iowa only that portion of the taxpayer's net income reasonably attributable to the trade or business done in Iowa since the taxing power exerted by this statute bears fiscal relation to the protection, opportunities and benefits given by the state.

The formulation by the Supreme Court of Iowa confuses the due process requirement of a nexus sufficient to support the exercise of a state's taxing power[7] (never in

[7] See *Wisconsin* v. *J.C. Penney Co., supra.*

dispute here) with the due process requirement that the tax be "fairly apportioned to the commerce carried on within the State." *Ott* v. *Mississippi Valley Barge Line Co., supra,* 336 U.S. at 174. To satisfy the former is not necessarily to meet the latter. Here, the stipulated facts conclusively show that Iowa attributes to itself income "out of all appropriate proportion to the business transacted" in Iowa. *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123, 135. In so doing it denies due process.

5. The Court's affirmance of the judgment below would undermine the gains toward uniformity of apportionment formulae which *General Motors* has promoted and would encourage an emerging trend toward parochial and protectionist state taxation of interstate commerce. This Court's decision in *General Motors, supra,* was an important incentive for the development of uniform taxation of income derived from interstate commerce. However, the court below has seized on the fact that the decision was statutory to ignore its basic teaching and to sustain a unique and aberrant taxing scheme.

The use of a three-factor property, payroll and sales apportionment formula by forty-four of the forty-six states with corporate income taxes represents the culmination of a continuing movement toward use of the three-factor formula during this century. While there still are differences among the states in their definitions of "property," "payroll" and "sales," the use of the same three factors in their apportionment formulae is an important step toward complete uniformity of apportionment formulae and thus toward elimination of multiple taxation.

In 1929, the sixteen states with corporate income taxes used eleven different apportionment formulae, the most popular of which were a one-factor formula based on property and a one-factor formula based on sales. By 1953, fifteen formulae were in use, but sixteen of the thirty-five states with corporate income taxes employed

the three-factor formula. Special Subcommittee on State Taxation of Interstate Commerce, House Committee on the Judiciary, *State Taxation of Interstate Commerce*, H.R. Rep. No. 1480, 88th Cong., 2d Sess. (Vol. 1) 119 (1964). The movement toward uniformity of factors was further aided by the adoption in 1957 by the National Conference of Commissioners on Uniform State Laws of the Uniform Division of Income for Tax Purposes Act (UDITPA), which provides in § 9 for a three-factor apportionment formula based on property, payroll and sales.[8]

In 1963, shortly before this Court's decision in *General Motors*, twenty-six of the thirty-eight states with corporate income taxes used the three-factor formula, and the number of different formulae in use had declined to eleven. *State Taxation of Interstate Commerce, supra*, at 119. As noted above, this Court's disapproval of the single sales-factor formula in *General Motors* in 1965 further accelerated that trend, so that today forty-four of the forty-six states taxing corporate income use the three-factor formula.

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[8] The Multistate Tax Compact was adopted in response to the enactment by Congress of P.L. 86-272, 73 Stat. 555 (1959) [15 U.S.C. §§ 381-84], and the introduction of H.R. 11798, 89th Cong., 1st Sess. (1965), as the result of the Congressional study of state taxation of interstate commerce mandated by P.L. 86-272. The acknowledged purpose of the Compact was to preempt potential Congressional legislation dealing with protection of interstate commerce from discriminatory taxation. The Compact, whose constitutionality is now at issue in this Court in another appeal, copied UDITPA.

The Multistate Tax Commission created by the Compact has been inconsistent in its support of the equally weighted three-factor formula required by UDITPA. For example, Florida, one of the seven founding members, was continued by the Commission as a full member of the Compact notwithstanding that state's adoption of a discriminatory double-weighted sales factor which violated the specific terms of the Compact. Moreover, the Multistate Tax Commission has promulgated regulations which obliterate key elements of UDITPA, particularly with respect to non-business income and the so-called unitary business-combined return concept.

Iowa's single sales-factor apportionment formula is a glaring exception to this trend. However, beginning in 1971, four states which utilize three-factor apportionment formulae—Florida, Wisconsin, New York and Massachusetts—have moved in the direction of Iowa's discrimination against out-of-state businesses by attributing double weight to the sales factor of the apportionment formula, a practice which incorporates to a lesser degree the vice of Iowa's single sales-factor formula.[9] The Court's refusal to hear the Moorman appeal would accelerate this emerging trend away from an equally weighted three-factor formula and thus would jeopardize the gains that have been made toward uniformity of apportionment and reduction in multiple taxation.

CONCLUSION

For the foregoing reasons, jurisdiction of this appeal should be noted.

Respectfully submitted,

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[9] In addition, a bill providing for double weighting of the sales factor was introduced in the Illinois State Senate on April 7, 1977. The bill, S.B. 737, came up for a final vote by the Senate on May 26, 1977, but was recommitted to the Senate Revenue Committee for further study of its revenue impact.